

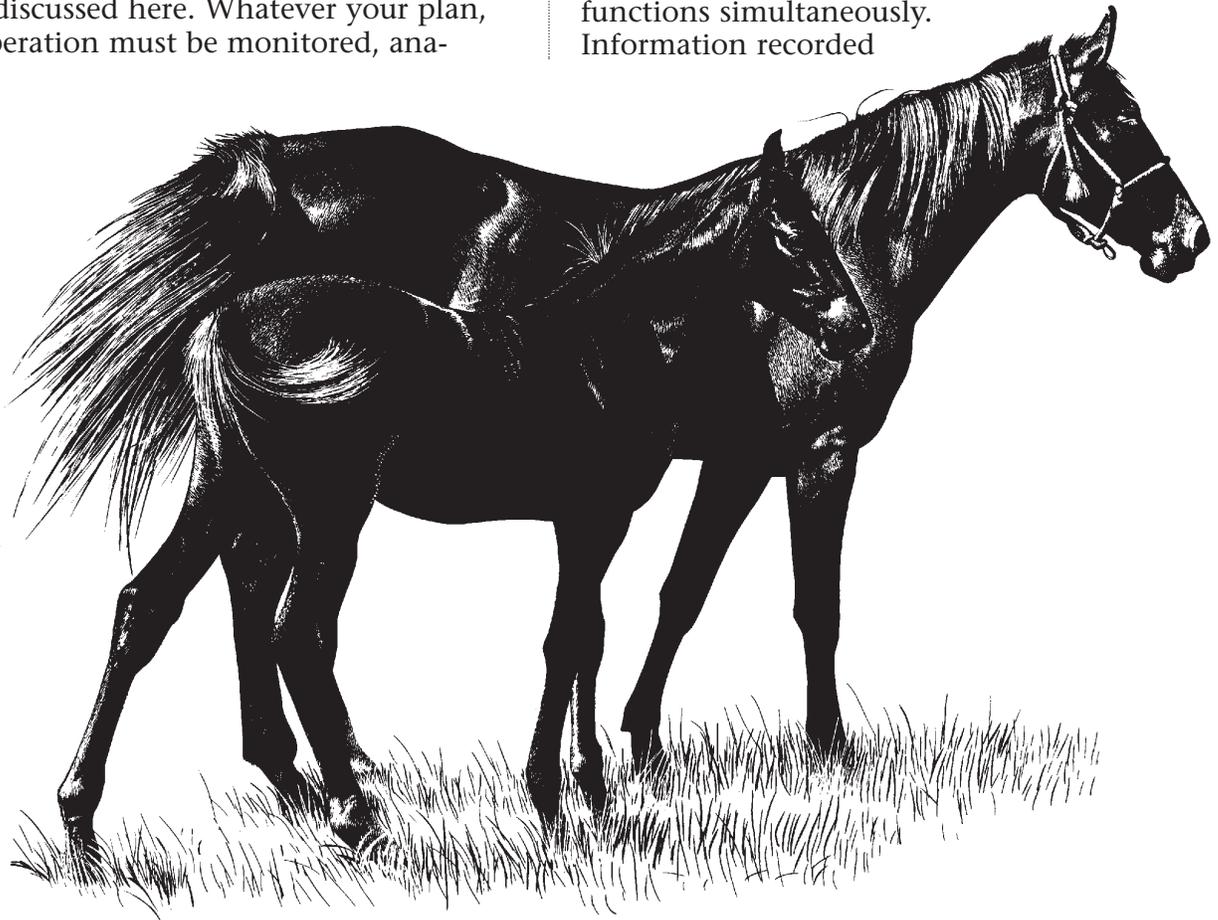
Financial Control Aids for Equine Enthusiasts

Balance Sheets, Income and Expense
Statements, and Cash-Flow Budgets

Two primary functions are involved in good financial management: planning and control. The planning function is discussed in Fact Sheet 657 *Financial Planning for Equine Enthusiasts: Enterprise and Partial Budgets*. The second primary function, control, is discussed here. Whatever your plan, your operation must be monitored, ana-

lyzed, and directed. The worst thing you can do is develop a plan and then ignore it.

Even though planning and control are presented in separate publications and as separate functions, both are ongoing, and breeders will often perform both functions simultaneously. Information recorded



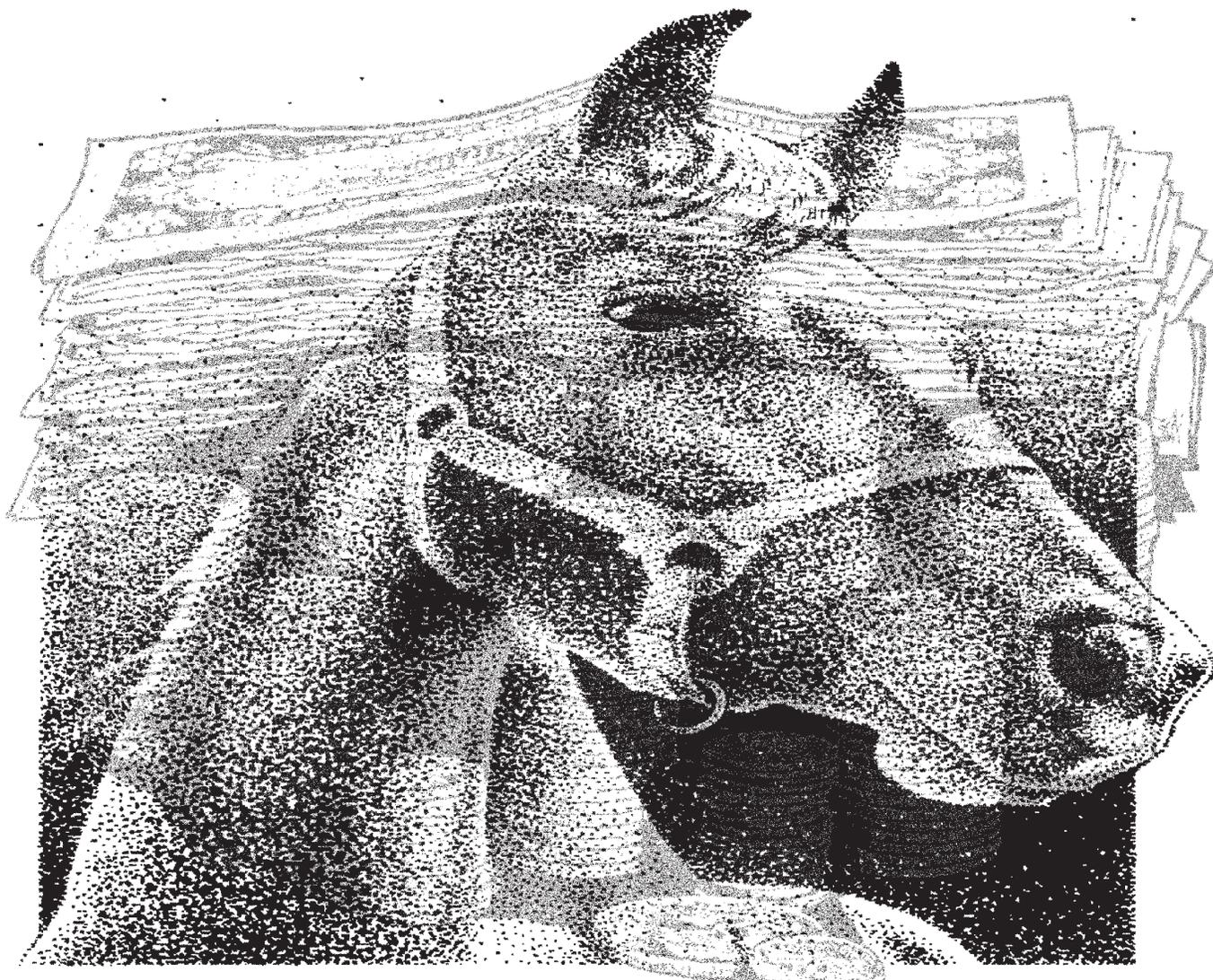
and analyses performed in the control function provide important data for generating long-range budgets.

Two basic financial documents are required to ensure an adequate control system: 1) a balance sheet and 2) an income and expense statement. Additionally, the preparation and periodic updating of a cash-flow budget is recommended. It is important to understand that these three financial documents serve different purposes. The balance sheet summarizes the financial condition of the business at a particular point in time, while the income and expense statement summarizes the equine-related financial transactions (e.g., revenues and expenses) that occur over a period of time. A cash-flow budget is similar to an income and expense statement, but includes only cash revenue and expense items and emphasizes the tim-

ing of these cash flows. Because many equine operations are recreational or not the primary source of financial support for the owner or breeder, the cash-flow budget is particularly important.

Balance Sheet

The balance sheet is a systematic listing of the assets and liabilities of an operation at a point in time. An inventory of the physical and financial assets is required to complete the balance sheet, and each asset's value must be determined before it is entered. The value of assets on a balance sheet should generally be the lower of either cost or market value. If the cost is lower than market value, cost should be used unless market value can be well documented by an independent authority.



Worksheet 1. Balance Sheet for XYZ Stable
December 31, 20__

Your figures

Assets

Current assets

| | | | |
|----------------------|------------|-----------------|--|
| Cash | \$5,000 | | |
| Accounts receivable | 2,000 | | |
| Prepaid expenses | 4,000 | | |
| Other | <u>500</u> | | |
| Total current assets | | <u>\$11,500</u> | |

Long-term assets

| | | | |
|-------------------------------|-----------------|----------------|--|
| Horses | \$25,000 | | |
| Land | 250,000 | | |
| Buildings | 50,000 | | |
| Equipment | 20,000 | | |
| Tack | <u>5,000</u> | | |
| Subtotal long-term assets | 350,000 | | |
| Less accumulated depreciation | <u>(20,000)</u> | | |
| Total long-term assets | | <u>330,000</u> | |

| | | | |
|--------------|--|------------------|--|
| Total assets | | <u>\$341,500</u> | |
|--------------|--|------------------|--|

Liabilities

Current liabilities

| | | | |
|---------------------------|------------|---------------|--|
| Accounts payable | \$2,000 | | |
| Notes payable | 25,000 | | |
| Taxes payable | 1,500 | | |
| Wages payable | <u>500</u> | | |
| Total current liabilities | | <u>29,000</u> | |

Long-term liabilities

| | | | |
|-----------------------------|--------------|----------------|--|
| Mortgages | \$100,000 | | |
| Other | <u>5,000</u> | | |
| Total long-term liabilities | | <u>105,000</u> | |

| | | | |
|-------------------|--|----------------|--|
| Total liabilities | | <u>134,000</u> | |
|-------------------|--|----------------|--|

Net worth

| | | | |
|-----------------------------------|--|------------------|--|
| Owner capital and total net worth | | <u>207,500</u> | |
| Total liability and net worth | | <u>\$341,500</u> | |

Worksheet 1 presents an example of a year-end balance sheet. Note that most of the assets are in the long-term category, and most of the liabilities are related to notes payable or mortgages. This example is representative of many equine balance sheets.

Data from the balance sheet are required to compute various ratios, from debt/equity to working capital. A thorough explanation of these ratios is beyond the scope of this fact sheet, but once the data have been gathered and organized on a balance sheet, ratio computation is simply a mathematical process.

A current balance sheet and balance sheets from past years, to establish financial patterns, have become standard required documents to secure most loans. This trend applies more to large or capital-intense operations, but it is a signal from financial institutions that they consider these documents essential to sound financial management.

Income and Expense Statement

An income and expense statement, as shown in Worksheet 2, is a summary of income and expense (usually related to a specific activity, such as horses) for a selected period of time (e.g., monthly, quarterly, or

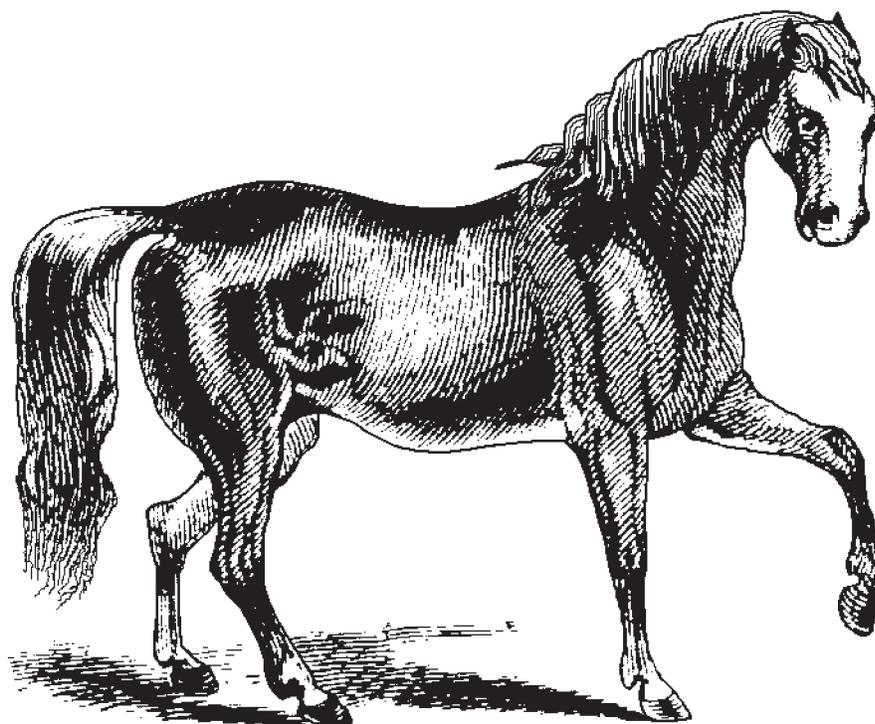
annually). It is used to determine the net profit or loss of the operation. It contains cash income and expenses as well as non-cash items such as depreciation and inventory changes.

In Worksheet 2, a net loss was incurred (which, unfortunately, is common for equine activities). However, the amount of the loss was reduced by a positive gross income. Even if your operation has no income from horses, preparing an expense statement is a recommended financial control tool in the effort to minimize losses.

Because a net loss is illustrated in Worksheet 2, no allowance is made for income tax. If you claim such a loss on your income tax, adjust the net profit (loss) figure to reflect any tax benefit you receive. If a profit had been shown, the profit figure would have been reduced by the applicable tax rate.

Cash-Flow Budget

As stated earlier, cash-flow budgets (Worksheet 3) are similar to income and expense statements in that they both show inflows and outflows of money. The two primary differences are these: 1) Depreciation is included as an expense on an income and expense statement, whereas on a cash-flow



Worksheet 2. Income and Expense Statement for XYZ Stable
January 1, 20__ —December 31, 20__

| | | | Your figures |
|-------------------------------|--------------|-------------------|---------------------|
| Income | | | |
| Sales | \$10,000 | | _____ |
| Boarding fees | 6,000 | | _____ |
| Training fees | <u>1,000</u> | | _____ |
| Gross income | | <u>\$17,000</u> | _____ |
| Expenses | | | |
| Cash expenses | | | |
| Wages | \$2,000 | | _____ |
| Local taxes and licenses | 2,000 | | _____ |
| Insurance | 1,000 | | _____ |
| Pasture | 500 | | _____ |
| Hay | 1,000 | | _____ |
| Mixed feeds | 750 | | _____ |
| Farrier | 750 | | _____ |
| Veterinarian/medicine | 900 | | _____ |
| Bedding | 750 | | _____ |
| Utilities | 300 | | _____ |
| Other | <u>1,000</u> | | _____ |
| Total cash expenses | | \$10,950 | _____ |
| Interest expense | | 1,095 | _____ |
| Noncash expenses ^a | | <u>20,000</u> | _____ |
| Total expenses | | <u>32,045</u> | _____ |
| Net profit (loss) | | <u>(\$15,045)</u> | _____ |

^aNoncash expenses or adjustments include depreciation, inventory changes, etc.

**Worksheet 3. Cash-Flow Budget for XYZ Stable
20__—Quarterly**

| Description | First quarter | Second quarter | Third quarter | Fourth quarter | Annual total |
|---|------------------|--------------------|------------------|-------------------|-----------------|
| 1. Beginning cash balance (from line 24, previous period) | \$ 1,000 | \$ 8,600 | \$1,100 | _____ | _____ |
| Income/receipts | | | | | |
| 2. Horse sales ^a | 2,500 | 0 | _____ | _____ | _____ |
| 3. Boarding fees | 1,200 | 1,400 | _____ | _____ | _____ |
| 4. Training fees | 150 | 200 | _____ | _____ | _____ |
| 5. Nonfarm income | 15,000 | 15,000 | _____ | _____ | _____ |
| 6. Investments | 350 | 200 | _____ | _____ | _____ |
| 7. Total cash available (add lines 1–6) | 20,200 | 25,400 | _____ | _____ | _____ |
| Operating expenses | | | | | |
| 8. Labor | 500 | 500 | _____ | _____ | _____ |
| 9. Insurance | 1,000 | 0 | _____ | _____ | _____ |
| 10. Pasture | 0 | 300 | _____ | _____ | _____ |
| 11. Hay | 400 | 100 | _____ | _____ | _____ |
| 12. Mixed feed | 300 | 100 | _____ | _____ | _____ |
| 13. Farrier | 200 | 200 | _____ | _____ | _____ |
| 14. Veterinarian/medicine | 200 | 200 | _____ | _____ | _____ |
| 15. Total cash operating expenses (add lines 8–14) | 2,600 | 1,300 | _____ | _____ | _____ |
| Capital expenditures | | | | | |
| 16. Horses and tack | 0 | 10,000 | _____ | _____ | _____ |
| 17. Machinery and equipment | 0 | 0 | _____ | _____ | _____ |
| 18. Family living expenses | 9,000 | 10,000 | _____ | _____ | _____ |
| 19. Income taxes | 0 | 1,500 ^b | _____ | _____ | _____ |
| Debt payment/service ^c | | | | | |
| 20. Interest | 0 | 100 | _____ | _____ | _____ |
| 21. Principal | 0 | 1,400 | _____ | _____ | _____ |
| 22. Total cash outflow (add lines 15–21) | 11,600 | 24,300 | _____ | _____ | _____ |
| 23. New borrowing | 0 | 0 | _____ | _____ | _____ |
| 24. Ending cash balance (add lines 7 and 23, then subtract line 22) | 8,600 | 1,100 | _____ | _____ | _____ |

^aIndividual line items such as “Horse sales” on line 2 and “Labor” on line 8 are used as examples only. When personalizing a budget, use entries that reflect your operation.

^bDue to April 15 and the IRS.

^cInterest and principal due on a short-term loan made in the previous year.

budget the entire cost of the capital (depreciable) item is included. 2) Cash-flow budgets include the total amount of cash flowing into and out of the operation, regardless of the source. In an operational income and expense statement only receipts and expenses that are directly related to the equine activity are included.

Cash-flow budgets for owners and breeders should contain all receipts and expenses, including such items as salary, income earned from other (nonhorse) businesses and investments, interest income, income taxes, and family living expenses. In equine operations such entries typically have a major effect on the amount of cash available for horse activities. Individuals who own and breed horses primarily as a nonbusiness activity are especially dependent on discretionary income, thus cash-flow budgets take on a magnified degree of importance.

The primary objective of cash-flow budgeting is planning. Analysis of past cash-flow budgets provides a basis for projecting fund supplies and demands. These supplies and demands may be highly seasonal, but with proper planning the potentially negative effects of seasonal gyrations can be minimized. Once the proper data have been gathered and analyzed, cash-flow requirements for both the shortrun and longrun should be projected. Failure to generate such projections causes the majority of financial management problems.

Conclusion

This material has been presented to help familiarize the reader with the basics of financial control. Such controls are a necessary component of a sound financial management system and should be incorporated into any equine operation, regardless of size or function.

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